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# Technology Transfers to China: An Outline of Chinese Law

PAUL B. BIRDEN, JR., ESQ.\*

## I. INTRODUCTION

In June 1993, China disclosed a shopping list of some 210 high technology items it wished to import between 1993 and the year 2000. This formidable list includes: (1) agricultural technology, including seed and livestock, irrigation, and water and soil transformation technology; (2) technology for several key power projects, including hydroelectric, coal, oil, and gas technology; (3) transportation technology, including bridge, deep-water berth, and highway technology; (4) railway technology, including railway electrification, communication, and signalling technology; (5) civil aviation technology, including navigational and meteorological technology; (6) post and telecommunications technology, including digital telephone and fiber optical technology; and (7) chemical technology and various education, machinery, textile, forestry, and urban construction technology.<sup>1</sup>

Two months later, China announced its interest in obtaining foreign partners in the development of yet another eighty-five major projects. These projects include: (1) several computer projects, including introduction of technological facilities for the manufacture of high quality electronic products, the production of 286 and 386 model microcomputer power supplies, and the furnishing of both hardware and software for the temperature and flow quad-

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1. See *Technology Import List*, CHINA DAILY (N. Am. ed.), June 28, 1993, Bus. Wkly., at 2; *A High-Tech Shopping List*, CHINA DAILY (N. Am. ed.), July 5, 1993, Bus. Wkly., at 2; *China's High-Tech Shopping List*, CHINA DAILY (N. Am. ed.), July 12, 1993, Bus. Wkly., at 2; *China's High-Tech Shopping List for 1993-2000*, CHINA DAILY (N. Am. ed.), July 19, 1993, Bus. Wkly., at 2.

ratic intelligent instruments and meters; (2) electronic projects, including facilities for the manufacture of advanced electronics parts; (3) chemical projects, including manufacture of propanediol ether, polycarbonate resin, polyphenylene sulphide, and alkyl benzene; and (4) medical projects, including manufacture of albomycin and josamycin, as well as the building of facilities for a children's medical center.<sup>2</sup>

Both the "shopping list" and the foreign cooperation solicitations evidence clearly that the diverse technologies China wishes to import cut across all sectors of the economy and all administrative levels.

While joint venturing remains a popular method of conducting business with China, it is a time-consuming and tedious method for transferring technology, often requiring years of negotiation. Many foreign firms prefer to market and transfer their proprietary technology through an assortment of commercial arrangements, such as outright sale or assignment, licensing, turn-key contracts, compensation trade agreements, and technical consultancy, training, service, or know-how contracts. These range from the relatively simple, as in the case of a pure licensing agreement, to the complex, as in turn-key or compensation trade agreements.

Like many lesser-developed nations, China often experiences shortages of capital, skilled labor, and management personnel. China may lack suitable environments to maintain the technology it wishes to acquire. This makes negotiating technology transfer contracts with China more difficult than conducting similar negotiations with more developed countries.<sup>3</sup>

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2. See *Foreign Partners Needed for 10 Major Projects*, CHINA DAILY (N. Am. ed.), Aug. 9, 1993, Bus. Wkly., at 7; *Foreign Cooperation Sought for 75 Major Projects in China*, CHINA DAILY (N. Am. ed.), Aug. 16, 1993, Bus. Wkly., at 5.

3. For an excellent overview of the problems inherent in transferring technology to lesser-developed countries, see generally MICHAEL BLAKENEY, *LEGAL ASPECTS OF THE TRANSFER OF TECHNOLOGY TO DEVELOPING COUNTRIES* (1989); Douglas F. Greer, *Control of Terms and Conditions for International Transfers of Technology to Developing Countries*, in *COMPETITION IN INTERNATIONAL BUSINESS* 41 (Oscar Schachter & Robert Hellawell eds., 1981). For an overview of technology transfers to China, see generally *LEGAL ASPECTS OF DOING BUSINESS WITH CHINA*, PRACTICING LAW INSTITUTE HANDBOOK NO. 405 (1986); ZHENG CHENGSI & MICHAEL D. PENDLETON, *CHINESE INTELLECTUAL PROPERTY AND TECHNOLOGY TRANSFER LAW* (1987).

Thus, technology transfer contracts with Chinese entities must be carefully negotiated and drafted.<sup>4</sup> While China has only one set of nationally-applied intellectual property laws, it has two distinct sets of nationally-applied contract and technology transfer contract laws: one for use between Chinese entities *inter se* and another for use between foreign entities and Chinese entities. In addition, there is local legislation that parallels the national legislation.<sup>5</sup>

To negotiate technology transfer contracts with their Chinese counterparts, it is necessary for foreign enterprises to understand the Chinese laws as well as the process as an integrated whole. This Article will discuss different legal aspects of transferring technologies to China, limited to an examination of the combined set of Chinese national contract and technology import laws.<sup>6</sup> Part II of this Article will give a brief overview of China's intellectual property laws and relevant international treaties. Next, Part III will survey other major Chinese laws that relate to the import of technology from abroad, with particular emphasis on its Foreign Economic Contract Law. Because there are several areas of contract law upon which the Foreign Economic Contract Law is silent, but which have been addressed by other legislation or judicial decisions, the discussion herein will also incorporate other legislation and judicial decisions where they relate to contracts between Chi-

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4. For information and guidance on drafting technology transfer agreements, see generally 1-3 L.W. MELVILLE, *FORMS AND AGREEMENTS ON INTELLECTUAL PROPERTY AND INTERNATIONAL LICENSING* (1993).

5. For a discussion on the differences between the two contract systems, see generally *Two Contract Systems: When Is a Foreigner Not a Foreigner?*, CHINA L. & PRAC., Apr. 1, 1987, at 12-14. Local legislation, although extremely important, is outside the scope of this Article and is, therefore, not discussed in depth. Where relevant, however, certain provisions are addressed in footnotes.

6. Because seemingly innocuous technology may be adapted for military use, numerous federal statutes regulate the export of technology from the United States. Primary legislation regulating U.S. export of technology are the Export Administration Act of 1979, 50 U.S.C. §§ 2400-2420 (amended 1985), and Bureau of Export Administration Regulation, 15 C.F.R. §§ 700-799 (reissued Jan. 1, 1993). The Bureau bans the export of commodities and data information outside the United States except under a general or validated license. Careful examination of the Regulations and Addenda, as well as other U.S. statutes, is necessary. The Coordinating Committee for Multilateral Export Controls ("COCOM"), an informal association of countries whose main objective is to control the export to communist countries of products that are capable of military application, has also established rules with which exporters must comply. For discussions of these matters, see Peter Swan, *A Roadmap to Understanding Export Controls: National Security in a Changing Global Environment*, 30 AM. BUS. L.J. 607 (1993); Cecelia A. Schier, *Technological Trade with the Former Eastern Block: The Evolution of Export Control and Its Relationship to Structural Trade Barriers*, 19 RUTGERS COMPUTER & TECH. L.J. 223 (1993).

nese and foreign entities. Part IV will review China's two major technology import laws together in detail. Finally, Part V will briefly consider pertinent aspects of negotiating contracts with China. An effort has been made throughout the Article to present a unified and coherent account of technology transfers to China.

## II. OVERVIEW OF CHINA'S INTELLECTUAL PROPERTY LAW

International enterprises weigh heavily the protection that a country will afford to foreign intellectual property before venturing into that country. To attract foreign business and technology, China recently passed and/or amended its intellectual property laws and acceded to several international conventions, providing for more protection to the owners of trademarks, patents, and other intellectual property.

### A. Membership in International Conventions

To strengthen its intellectual property protection regime and to enhance its stature worldwide, China acceded, in 1985, to the International Convention for the Protection of Industrial Property ("Paris Convention")<sup>7</sup> and, in 1989, to the Madrid Agreement Concerning the International Registration of Marks ("Madrid Agreement").<sup>8</sup> In 1992, China finally acceded to the International Convention for the Protection of Literary and Artistic Works ("Berne Convention")<sup>9</sup> and the Universal Copyright Convention.<sup>10</sup> China also agreed to accede to the Convention for the Protection

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7. International Convention for the Protection of Industrial Property, Mar. 20, 1883, 828 U.N.T.S. 307 (revised July 14, 1967) [hereinafter Paris Convention]. China acceded to the Convention on March 19, 1985. See INDUSTRIAL PROPERTY: MONTHLY REVIEW OF THE WORLD INTELLECTUAL PROPERTY ORGANIZATION, Jan. 1992, at 6.

8. Madrid Agreement Concerning the International Registration of Marks, Apr. 14, 1891, 828 U.N.T.S. 389 (revised Oct. 4, 1989) [hereinafter Madrid Agreement]. China acceded to the Agreement on October 4, 1989. See INDUSTRIAL PROPERTY: MONTHLY REVIEW OF THE WORLD INTELLECTUAL PROPERTY ORGANIZATION, *supra* note 7, at 10. The United States is not a signatory to the Madrid Agreement, although it has shown interest in acceding to the June 27, 1989 Protocol to the Agreement. For a discussion of both the Madrid Agreement and the 1989 Protocol, see Gerd F. Kunze, *The Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks of June 27th, 1989*, 82 TRADEMARK REP. 58 (1992).

9. See *New Regulations on Berne Accession*, ASIA L. & PRAC., Oct. 22, 1992, at 23; Fred M. Greguras et al., *Survey of International Legal Protection for Software*, IP ASIA, Apr. 22, 1991, at 12-13 n.4 (1993).

10. *New Regulations on Berne Accession*, *supra* note 9, at 23.

of Producers of Phonograms Against Unauthorized Duplication of Their Phonograms.<sup>11</sup>

### B. Trademark Law

China enacted trademark legislation in April 1963 promulgating trademark management regulations,<sup>12</sup> which remained in effect in 1980 when China became a signatory to the World Intellectual Property Organization.<sup>13</sup> The 1963 trademark legislation, however, was later abrogated in August 1982, when the Standing Committee of China's National People's Congress promulgated the Trademark Law, effective March 1, 1983.<sup>14</sup> China enacted rules to implement the Trademark Law on March 10, 1983.<sup>15</sup> Separate measures for trademark registration by foreigners and foreign entities were enacted in September 1983.<sup>16</sup> On January 13, 1988, China replaced the 1983 Implementing Rules with a new set of detailed implementing rules.<sup>17</sup>

In 1992, applicants submitted more than 90,000 applications—including 8,300 foreign applications—for trademark registration, compared to 18,500—including 1,565 foreign applications—in 1982. By 1992, China's valid trademark registrations totalled

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11. 1992 Highlights Directory and Index, IP ASIA 7 (1992).

12. Robert Patch, *New Trademark Law Permits Company Registrations*, E. ASIAN EXECUTIVE REP., Nov. 1982, at 6. Mr. Patch provides a thumb-nail sketch of the background and history of trademark law.

13. INDUSTRIAL PROPERTY: MONTHLY REVIEW OF THE WORLD INTELLECTUAL PROPERTY ORGANIZATION, *supra* note 7, at 3. The World Intellectual Property Organization was established on July 14, 1967. China became a signatory on June 3, 1980. See Convention Establishing the World Intellectual Property Organization, July 14, 1967, 828 U.N.T.S. 3 (effective Apr. 26, 1970) (amended 1979).

14. Zhonghua Renmin Gongheguo Shangbiaofa [Trademark Law of the P.R.C.], reprinted in ZHONGGUO SHEWAI JINGJI FAGUI HUIBIAN [CHINA'S FOREIGN ECONOMIC LEGISLATION], 1949-1985, 1149; Trademark Law of the P.R.C., 2 China L. Foreign Bus. (CCH) ¶ 11-500 (1993). Article 43 repeals the Shangbiao Guanli Tiaoli of April 10, 1963. See also Regulations Implementing New Trademark Law Issued, E. ASIAN EXECUTIVE REP., June 1983, at 11.

15. Zhonghua Renmin Gongheguo Shangbiaofa Shishi Xize [Detailed Regulations for the Implementation of the Trademark Law of the P.R.C.], reprinted in CHINA'S FOREIGN ECONOMIC LEGISLATION, *supra* note 14, at 1157.

16. Waiguoren Huo Waiguo Qiye Shenqing Shangbiaofa Zhuze Daili Banfa [Procedures for Agents of Foreigners and Foreign Entities Applying for Trademark Registration], reprinted in CHINA'S FOREIGN ECONOMIC LEGISLATION, *supra* note 14, at 1162.

17. Detailed Regulations for the Implementation of the Trademark Law of the P.R.C., *supra* note 15, reprinted in 2 China L. Foreign Bus. (CCH) ¶ 11-520 (1993) (English translation).

366,000.<sup>18</sup> Despite these figures, Chinese legislators met in December 1992 to consider amending the Trademark Law to address service mark protection, registration of trademarks through deceptive means, prohibition of the use of names of administrative regions as trademarks, and to simplify further registration procedures and extend the time period within which disputes over trademarks could be raised.<sup>19</sup> As a result, repromulgation of the Trademark Law occurred on February 22, 1993, and became effective on July 1, 1993.<sup>20</sup> The Law now protects service marks as well as trademarks and imposes heavier sanctions upon those who "pass off" registered trademarks.<sup>21</sup>

### C. Copyright Law

China adopted its Copyright Law<sup>22</sup> and the Implementing Rules<sup>23</sup> in September 1990, both effective as of June 1, 1991. The Copyright Law specifically listed computer softwares as protectible works;<sup>24</sup> however, they are protected in separate regulations.<sup>25</sup> In 1991, China enacted Computer Software Protection Rules<sup>26</sup> and Computer Software Copyright Registration Measures,<sup>27</sup> which protect foreigners' computer programs, including source code, target programs, and files<sup>28</sup> upon proper registration.<sup>29</sup>

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18. *Trademark Seekers Set a Record Last Year*, CHINA DAILY (N. Am. ed.), Feb. 6, 1993, Bus. Wkly., at 1.

19. *Legislators Move To Revise the Trademark Law*, CHINA DAILY (N. Am. ed.), Dec. 26, 1992, Bus. Wkly., at 3.

20. *Standing Committee of the National People's Congress, Amendment of the Trademark Law Decision*, CHINA L. & PRAC., Apr. 29, 1993, at 42-44 [hereinafter *1993 Amendments*]. See also *A Revised Trademark Law Takes Effect Soon*, CHINA DAILY (N. Am. ed.), June 28, 1993, Bus. Wkly., at 2.

Promulgation of two other important laws occurred on February 22, 1993: *The P.R.C. Product Quality Law*, CHINA L. & PRAC., Mar. 25, 1993, at 4; and *Standing Committee of the National People's Congress' Supplementary Provisions of the Crime of Passing Off Registered Trademarks*, CHINA L. & PRAC., Apr. 29, 1993, at 4 [hereinafter *Passing Off Provisions*].

21. Trademark Law of the P.R.C., *supra* note 14, arts. 27, 40.

22. Copyright Law of the P.R.C., 2 China L. Foreign Bus. (CCH) ¶ 11-700 (1993).

23. Implementing Rules for the Copyright Law of the P.R.C., 2 China L. Foreign Bus. (CCH) ¶ 11-702 (1993) [hereinafter *Copyright Law Implementing Rules*].

24. Copyright Law of the P.R.C., *supra* note 22, art. 3.

25. *Id.* art. 53.

26. Computer Software Protection Rules, 2 China L. Foreign Bus. (CCH) ¶ 11-704 (1993).

27. Measures for Computer Software Copyright Registration, 2 China L. Foreign Bus. (CCH) ¶ 11-706 (1993) [hereinafter *Software Registration Measures*].

28. Computer Software Protection Rules, *supra* note 26, art. 3.

29. Software Registration Measures, *supra* note 27, arts. 4-5.

As enacted, the Copyright Law suffered from several deficiencies. Significantly, it failed to protect foreign works that were not first published in China or otherwise protected under an international or multilateral treaty.<sup>30</sup> Although the United States acceded to the 1971 Paris Revision of the Berne Convention in 1989,<sup>31</sup> China had yet to accede to the Berne Convention when it enacted its Copyright Law. Thus, United States' works were not protected under China's Copyright Law.

In January 1992, China and the United States signed a Memorandum of Understanding ("MOU"),<sup>32</sup> in which China agreed to amend its Copyright Law and Implementing Regulations and to accede to the Berne Convention.<sup>33</sup> Pursuant to the MOU and through Provisions Implementing International Copyright Treaties,<sup>34</sup> China made several key amendments to its Copyright Law and Computer Software Protection Regulations,<sup>35</sup> which, thereafter, enabled China to accede to the Berne Convention.<sup>36</sup>

#### D. Patent Law

China's Patent Law was first adopted in March 1984,<sup>37</sup> while the rules implementing it<sup>38</sup> were enacted in January 1985. Both the Patent Law and the Implementing Regulations became effective as of April 1, 1985. Pursuant to the Law, patent protection was extended to inventions, utility models, and designs, but not to pharmaceuticals and chemicals.<sup>39</sup> Additionally, the Law required patent owners to manufacture their products in China or face compulsory licensing.<sup>40</sup>

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30. *China, Thailand, Indonesia Among Countries Criticized for Inadequate Protection of Intellectual Property*, E. ASIAN EXECUTIVE REP., Mar. 1991, at 8.

31. *See MPEAA Seeks Copyright and Court Reforms*, IP ASIA, June 18, 1992, at 17.

32. *PRC, US Protection of Intellectual Property Memorandum of Understanding*, CHINA L. & PRAC., Feb. 7, 1992, at 4.

33. Joseph Simone, *Super 301 Terminated*, ASIA L. & PRAC., Jan. 30, 1992, at 30.

34. *Implementing International Copyright Treaties Provisions*, CHINA L. & PRAC., Jan. 14, 1993, at 36 [hereinafter *Treaty Implementing Provisions*]. The State Council promulgated these provisions on September 25, 1992.

35. *New Regulations on Berne Accession*, *supra* note 9, at 24.

36. *Id.*

37. *Zhonghua Renmin Gongheguo Zhuanlifa* [Patent Law of the P.R.C.], reprinted in 2 *China L. Foreign Bus. (CCH)* ¶ 11-600 (1993) (English translation).

38. *Zhonghua Renmin Gongheguo Zhuanlifa Shishi Xize* [Implementing Regulations of the Patent Law of the P.R.C.], reprinted in 2 *China L. Foreign Bus.* ¶ 11-603 (1993) (English translation) [hereinafter *Patent Law Implementing Rules*].

39. Patent Law of the P.R.C., *supra* note 37, arts. 2, 25.

40. *Id.* arts. 51, 52.



In addition to promising, in the January 1992 MOU, to amend its Copyright Law, China promised to amend its Patent Law.<sup>41</sup> Thus, in September 1992, the Standing Committee of the National People's Congress revised the Patent Law, to be effective January 1, 1993.<sup>42</sup>

The main beneficiaries of the new amendments were pharmaceutical and chemical companies. The amendments extended patent protection to chemicals, pharmaceuticals, foods, beverages, and flavorings,<sup>43</sup> and relaxed the compulsory licensing provisions.<sup>44</sup> As added protection for pharmaceuticals, the State Pharmaceutical Administration promulgated Regulations for the Administrative Protection of Pharmaceuticals in December 1992.<sup>45</sup> Under the Regulations, foreigners may apply for administrative protection of certain types of pharmaceuticals if their country has entered into a bilateral treaty or agreement with China on the administrative protection of pharmaceuticals.<sup>46</sup>

### III. OVERVIEW OF MAJOR LAWS RELEVANT TO TECHNOLOGY TRANSFER

The 1984 Provisional Regulations on Technology Imports into the Shenzhen Special Economic Zone was one of the first major laws governing foreign technology imports.<sup>47</sup> It is described as one of the most elaborate set of rules governing technology transfers to China.<sup>48</sup> The Provisional Regulations on Technology Transfer,<sup>49</sup>

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41. See PRC, *US Protection of Intellectual Property Memorandum of Understanding*, *supra* note 32.

42. *Standing Committee of the National People's Congress, Amendment of the P.R.C., Patent Law Decision*, CHINA L. & PRAC., Nov. 5, 1992, at 42.

43. The amended Patent Law no longer denies patent rights to food, beverages, flavorings, pharmaceutical products, and substances obtained by means of a chemical process. *Id.*

44. Patent Law of the P.R.C., *supra* note 37, arts. 51-56.

45. Administrative Protection of Pharmaceuticals Regulations, CHINA L. & PRAC., Mar. 25, 1993, at 37.

46. *Id.*

47. Provision Regulation of the Shenzhen Special Economic Zone Governing the Import of Technology, 2 CHINA L. FOREIGN BUS. (CCH) ¶ 73-510 (1993) [hereinafter *Shenzhen Import Regulation*]. The Shenzhen Economic Contracts Provisions, which parallel the Economic Contract Law, were promulgated on February 7, 1984. For an English translation of the Provisions, see CHINA BUS. REV., Sept.-Oct. 1984.

48. Frankie Leung, Esq., *Recent Technology Transfer Regulations: Some Comments*, E. ASIAN EXECUTIVE REP., Mar. 1985, at 9.

49. Provisional Regulations of the State Council on Technology Transfer, Jan. 10, 1985 (P.R.C.) [hereinafter *Provisional Transfer Regulations*].

the Provisions of the Xiamen Special Economic Zone,<sup>50</sup> and the Provisional Regulations of the Guangzhou Economic and Technical Development Zone on Technology Import<sup>51</sup> followed the Shenzhen Regulations in 1985.

Also in 1985, other legislation affecting technology transfers from foreign to Chinese entities appeared when China enacted the Foreign Economics Contract Law ("FECL")<sup>52</sup> and the Regulations on the Administration of Technology Import Contracts ("ICAR").<sup>53</sup> Additionally, in 1988, China promulgated the Administration of Technology Import Contracts Regulations Implementing Rules ("ICARIR").<sup>54</sup> Both the ICAR and the ICARIR require technology import contracts to comply with the FECL.<sup>55</sup>

*A. The U.N. Convention on Contracts for the International Sale of Goods*

On December 11, 1986, China ratified the United Nations Convention on Contracts for the International Sale of Goods ("CISG").<sup>56</sup> The CISG is an international convention ratified by several contracting countries that aim to harmonize international commercial law and sales transactions.<sup>57</sup> The CISG primarily ad-

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50. Regulation on the Import of Technology to the Xiamen Special Economic Zone, Special Zones & Cities (CCH) ¶ 76-509 (1993) [hereinafter Xiamen Import Regulation].

51. Provisional Regulation of the Guangzhou Economic and Technological Development Zone on Technology Import, Special Zones & Cities (CCH) ¶ 85-209 (1993) [hereinafter Guangzhou Import Regulation].

52. Foreign Economic Contract Law of the P.R.C., 1 Bus. Reg. China L. Foreign Bus. (CCH) ¶ 5-550 (1993) [hereinafter FECL] (adopted at the Standing Committee of the National People's Congress, 10th Sess., Mar. 21, 1985).

53. Regulation on the Administration of Technology Import Contracts of the P.R.C., 1 Bus. Reg. China L. Foreign Bus. (CCH) ¶ 5-570 (1993) [hereinafter ICAR] (promulgated May 24, 1985 by the State Council).

54. Detailed Rules for the Implementation of the Administrative Regulations of the P.R.C. on Technology Import Contracts, 1 Bus. Reg. China L. Foreign Bus. (CCH) ¶ 5-573 (1993) [hereinafter ICARIR] (promulgated Jan. 20, 1988 by the Ministry of Foreign Economic Relations and Trade).

55. ICAR, *supra* note 53, art. 5; ICARIR, *supra* note 54, art. 7.

56. U.N. Convention on Contracts for the International Sale of Goods, U.N. Doc. A. CONF. 97/18 (1980) (effective Jan. 1, 1988), *reprinted in* THE CONVENTION FOR THE INTERNATIONAL SALE OF GOODS: A HANDBOOK OF BASIC MATERIALS 28-62 (Reed R. Kathrein & Daniel B. Magraw eds., 1987) [hereinafter CISG].

57. See generally JOHN O. HONNOLD, UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CONVENTION (1990). This book is considered one of the most definitive treatises on the CISG. For another excellent treatise on the CISG containing a Chinese language version of the Convention, see also FRITZ ENDERLEIN & DIETRICH MASKOW, INTERNATIONAL SALES LAW 71 (1992).

addresses the following: (1) the formation of contracts for the international sales of goods; (2) the rights and duties of buyers and sellers after formation; (3) methods of handling breach of contract; and (4) physical aspects of goods such as transport, damage, destruction, and deterioration.<sup>58</sup>

After China joined the CISG, its Ministry of Foreign Economic Relations and Trade ("MOFERT")<sup>59</sup> directed its foreign trade officials to become familiar with and implement the CISG by January 1, 1988. The CISG was to apply to all contracts for the international sale of goods entered into by Chinese corporations with corporations from other signatory countries where no choice of law had been made.<sup>60</sup> Pursuant to one important feature of the CISG, parties whose contracts are governed by the CISG can opt out and choose whatever law they wish to govern their contract.<sup>61</sup>

By its terms, the CISG only applies to contracts for the sale of goods,<sup>62</sup> and does not apply to contracts furnishing labor or other services.<sup>63</sup> Furthermore, the CISG may only be of limited application to technology transfers, which usually embrace patent and know-how licensing.<sup>64</sup> Thus, the CISG appears to exclude many technology transfer contracts.

Problems arise, however, where the contracts involved provide both goods and services. Whether or not the CISG will apply to

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58. See HONNOLD, *supra* note 57; ENDERLEIN & MASKOW, *supra* note 57. The CISG is divided into four parts: Part I—Sphere of Application and General Provisions; Part II—Formation of the Contract; Part III—Sale of Goods; and Part IV—Final Provisions. *Id.* For a discussion of CISG provisions that conflict with or complement Chinese law, see also U.N. Convention on Contracts for the International Sale of Goods (1980), *reprinted in* CHINA L. & PRAC., June 11, 1987, at 24.

59. MOFERT is currently undergoing major changes and is now known as the Ministry of Foreign Trade and Economic Cooperation, or MOFTEC. See *MOFERT's New Look*, CHINA BUS. REV., July-Aug. 1993, at 38-39. For evidence that MOFERT is now defunct, see also *Who's Who at the Shenzhen Conference*, CHINA DAILY (N. Am. ed.), Aug. 16, 1993, Bus. Wkly., at 5 (noting one of the delegates as Ms. Wu Yi, a Minister from the Ministry of Foreign Trade and Economic Cooperation). Throughout this Article, the old acronym, MOFERT, will be used.

60. *MOFERT, Several Issues To Note When Implementing the United Nations Convention for the International Sale of Goods*, translation available in 2 CHINA L. & PRAC., Sept. 26, 1988, at 61.

61. CISG, *supra* note 56, arts. 6, 12.

62. *Id.* art. 1(1).

63. *Id.* art. 3.

64. See ICAR, *supra* note 53, art. 2. Article 2 notes that technology contracts include assignment or licensing of patent or other industrial property rights, know-how provided in the form of drawings, technical data, technical specifications, etc. *Id.* Clearly, none of these items would be considered "goods."

these contracts depends on whether the contracts predominantly involve the supply of goods or the supply of services. The greater the value of the goods in relation to the value of the services, the greater the probability that the CISG applies to the contract.<sup>65</sup> Thus, any contract providing for both goods and services should be examined carefully to assess the likelihood of the CISG's application and to determine whether to adopt or opt out of the CISG.<sup>66</sup>

### *B. Foreign Economic Contract Law of the People's Republic of China*

China adopted the Foreign Economic Contract Law ("FECL") at the Tenth Session of the Standing Committee of the Sixth National People's Congress on March 21, 1985.<sup>67</sup> The FECL became effective on July 1, 1985,<sup>68</sup> although contracts concluded before the effective date were made subject to the FECL at the option of the parties.<sup>69</sup> Rules implementing the FECL<sup>70</sup> were not forthcoming, however. In their absence, several provisions of the 1986 Civil Code addressed contract matters,<sup>71</sup> and, in 1987, the Supreme People's Court further clarified the FECL in its Response to Certain Questions Concerning the Application of the FECL ("SCR").<sup>72</sup>

#### 1. Scope of the FECL

The FECL has two stated objectives: (1) protecting the lawful rights and interests of parties to foreign economic contracts; and

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65. HONNOLD, *supra* note 57. Professor Honnold suggests that, in some instances, the parties might choose to draft two contracts: one for the supply of goods and another for the supply of services. The CISG would, of course, apply to the first but not the second.

66. When opting out of the CISG, care should be taken to ensure that another law containing the CISG is not chosen. The choice of another law must be specific in order to be effective.

67. See FECL, *supra* note 52.

68. *Id.* art. 43.

69. *Id.* art. 41.

70. *Id.* art. 42.

71. *Civil Code General Rules*, E. ASIAN EXECUTIVE REP., Sept.-Oct. 1986 (Frankie Leung, Esq. trans.). See also William C. Jones, Esq., *The New General Rules: A Realistic Perspective on Chinese Civil Law*, E. ASIAN EXECUTIVE REP., Sept. 1986 (noting that the General Rules lack roots in Chinese tradition and appear to be patterned on German Law).

72. Response of the Supreme People's Court to Certain Questions Concerning the Application of the Foreign Economic Contract Law, 1 Bus. Reg. China L. Foreign Bus. (CCH) ¶ 5-555 (1993) [hereinafter SCR].

(2) promoting the development of China's foreign economic relations.<sup>73</sup> The FECL applies to economic contracts between Chinese economic entities and foreign enterprises, organizations, and individuals; however, the FECL does not apply to international transport contracts.<sup>74</sup> Contracts made under the FECL must implement principles of equality and mutual benefit, with a view toward achieving unanimity through consultations<sup>75</sup> according to Chinese law and in deference to Chinese public interest.<sup>76</sup>

Although the FECL itself does not define contracts, the Civil Code defines them as agreements between parties that establish, change, or terminate civil relations. Contracts concluded consistently with the law are protected by the FECL.<sup>77</sup> The term "economic contracts" encompasses a wide array of contracts, including commodity trade, cooperative enterprise, credit, exploration or exploitation of natural resources, technology transfer, labor, scientific, technical consultancy or design service, and agency contracts.<sup>78</sup> Because essential information about a product or a service is often explained or described in appendices, the FECL makes appendices an integral part of the contract.<sup>79</sup>

China has two sets of nationally-applied contract and technology contract laws. One set is used for contracts and technology transfers between Chinese entities *inter se*, while the other is used for contracts and technology transfers from foreign entities to Chinese entities. The FECL does not apply to economic contracts concluded between a Chinese-foreign cooperative venture or foreign investment enterprise ("FEI") established in China, on one hand, and a domestic Chinese enterprise on the other. In these situations, the Economic Contract Law applies to contracts made between such parties.<sup>80</sup>

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73. FECL, *supra* note 52, art. 1.

74. *Id.* art. 2.

75. *Id.* art. 3.

76. *Id.* art. 4.

77. General Code of the Civil Law of the P.R.C. art. 85 [hereinafter CC].

78. SCR, *supra* note 72, art. 1(1). Most of these contracts would not be covered by the CISG.

79. FECL, *supra* note 52, art. 8.

80. SCR, *supra* note 72, art. 1(3).

## 2. Contract Formation

Oral contracts are not honored under the FECL, which specifies that contracts formed under it be in writing and signed by the parties. Where one party asks to sign a confirmation letter which contains the agreement, a contract is formed only when the letter is signed by both parties. In order for a contract to be formed under the FECL, it must be approved by the competent state authority.<sup>81</sup>

Contract clauses that violate China's law or public policy are invalid. A contract need not be invalidated, however, if the parties cancel or revise the offensive clauses through consultation.<sup>82</sup> Contracts reached by fraud or duress are also invalid,<sup>83</sup> and the party responsible for the invalidity of the contract is obligated to pay the other party for any resulting losses.<sup>84</sup>

## 3. The Nature of Contractual Obligations

The Civil Code defines "obligations" as specific rights and duties arising between parties under a contract or a provision of law.<sup>85</sup> The party enjoying the rights is the "obligee," while the person assuming the duties is the "obligor." The obligee may demand that the obligor perform its contractual or legal duties.<sup>86</sup>

When there are multiple obligees, they enjoy rights proportionally to their respective shares. Multiple obligors will likewise share duties.<sup>87</sup> When there are multiple obligees or obligors, and the contract or the law allows the joint obligees' rights, then any of the obligees may demand any of the obligors to perform. Each obligor is also held responsible for discharging the entire obligation. A party who fully performs the obligation may seek indemnification from the other obligors according to the respective

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81. FECL, *supra* note 52, art. 7. Such traditional common law concepts as offer and acceptance are not part of the definition of a contract under the Chinese Civil Code. See generally Jesse T.H. Chang & Elson Pow, *Dealing with the Rules*, E. ASIAN EXECUTIVE REP., Jan. 1986, at 8. Offer and acceptance are, however, covered in detail in Articles 14 to 24 of the CISG. CISG, *supra* note 56, arts. 14-24. Also, while oral contracts are acceptable under the CISG, China does not accede to the CISG provision allowing for oral contracts. See *id.* at 24.

82. FECL, *supra* note 52, art. 9. See also SCR, *supra* note 72, art. 5(1).

83. FECL, *supra* note 52, art. 10.

84. *Id.* art. 11.

85. CC, *supra* note 77, art. 84.

86. *Id.*

87. *Id.* art. 86.

shares.<sup>88</sup> Two or more parties who jointly infringe upon another's rights and cause him damage will be jointly liable to that party.<sup>89</sup> The Civil Code provides for a type of contributory negligence by reducing a party's liability where the victim is also at fault.<sup>90</sup> When damage results through no fault of either party, the parties may share civil responsibilities.<sup>91</sup>

#### 4. Obligatory Considerations Under Foreign Economic Contracts

The FECL requires that ten matters be addressed in foreign economic contracts:

1. The parties' corporate or personal names, nationalities, principal place of business, or residence.
2. Date and place of making.
3. Class of contract and the type and scope of its subject matter.
4. Technical conditions, quality, standard, specifications, and quantities of the contract's subject matter.
5. Time limit, place, and method of performance.
6. Terms, price, amount and method of payment, and other additional changes.
7. Whether the contract is assignable and under what conditions.
8. Compensation for breach of contract.
9. Dispute settlement methods.
10. The language in which the contract is to be expressed.<sup>92</sup>

In addition, the risks borne by the parties should also be outlined in the contract.<sup>93</sup> Where contract performance takes place continuously over a long period of time, the parties should set a

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88. *Id.* art. 87.

89. *Id.* art. 130.

90. *Id.* art. 131.

91. *Id.* art. 132.

92. FECL, *supra* note 52, art. 12. The FECL does not require that the language of the contract be Chinese. *See also infra* notes 189, 191-92. Article 40 of the Shenzhen Foreign Economic Contracts Provisions, however, provides that if Chinese is one of the contract languages, the Chinese language document will be controlling. *See Provisions of the Shenzhen Special Economic Zone on Economic Contracts Involving Foreign Interests*, art. 40, in 3 CHINA'S FOREIGN ECONOMIC LEGISLATION 319 (1987).

93. FECL, *supra* note 52, art. 13.

valid term for the contract and may also set conditions for extension or early termination.<sup>94</sup>

### 5. Rules of Construction

Although the FECL provides little guidance on contract interpretation, the Civil Code compensates for this defect. Where the parties cannot resolve ambiguous terms through mediation, the contract is interpreted according to the Civil Code's rules of construction. First, if the quality term is unclear, quality standards of the state should apply; if no state standard exists, the usual standard should apply. Second, if the time for performance is unclear, the obligor may perform at any time, and the obligee may request performance at any time. Either party must give the other sufficient time to prepare for performance.<sup>95</sup> Third, if the place of performance is unclear and the contractual objective is the payment of money, the place of performance is where the payee is located. If the contractual objective is something other than the payment of money, the place of performance is where the obligor is located. Fourth, if the price term is unclear, the state-fixed price will apply; if no state-fixed price exists, the price should reflect the market price, the price of similar goods, or the standard remuneration for similar labor. Finally, if the contract fails to specify which party has the right to apply for a patent, the inventor has the right to apply. If the contract does not specify which party has the right to use scientific and technological results, all the parties have the right to use them.<sup>96</sup>

### 6. Contract Performance and Liabilities for Breach of Contract

Contracts formed in compliance with the FECL are legally binding, and parties thereto may not arbitrarily alter or terminate

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94. *Id.* art. 14. The FECL does not require the inclusion of an arbitration clause; however, one should be included under the section addressing dispute settlement describing arbitral issues, governing law, place of the arbitration hearing, how costs are to be borne, the currency in which awards are to be paid, and other matters. For a discussion of the arbitration process in general and examples of arbitration clauses, see generally ROBERT GOLDSCHIEDER & MICHEL DEHAAS, *ARBITRATION AND THE LICENSING PROCESS* (1981).

95. CC, *supra* note 77, art. 88. The Civil Code gives no indication of what will be deemed a reasonable length of time within which to prepare a contract.

96. *Id.*



them.<sup>97</sup> The Civil Code requires parties to discharge fully their respective obligations under the terms and conditions of the contract.<sup>98</sup>

Citizens or legal persons in breach of a contract or who do not perform their obligations must bear civil liability.<sup>99</sup> Should a party fail to perform its contractual obligation, the Civil Code allows the other party to demand performance or compensation.<sup>100</sup> Additionally, the FECL permits the party to take other reasonable remedial measures.<sup>101</sup>

A party may temporarily suspend performance of its obligations if it conclusively proves that the other party cannot perform its obligations. The suspending party should promptly notify the other party of the suspension. If, however, the other party fully guarantees performance, the suspending party must perform its obligation. If a party suspends performance without conclusive proof that the other party is unable to perform, the suspending party is liable for breach.<sup>102</sup>

## 7. Damages

If the losses suffered are not fully compensated by remedial measures, the aggrieved party may claim damages.<sup>103</sup> The liability for breach should equal the loss sustained by the non-breaching party; however, it may not exceed losses that were reasonably foreseeable when the contract was made.<sup>104</sup> Damages may include payment for loss or destruction of property, expenses incurred in

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97. FECL, *supra* note 52, art. 16. A distinction must be made between documents called "contracts" (*hetong*) and those called "agreements" (*xieyi*). The former are binding legal statements of intent to do business on specific terms, while the latter are binding only as a statement of intent. LEGAL ASPECTS OF DOING BUSINESS WITH CHINA, *supra* note 3, at 44.

98. CC, *supra* note 77, art. 88.

99. *Id.* art. 106.

100. *Id.* art. 111.

101. FECL, *supra* note 52, art. 18.

102. *Id.* art. 17. Article 71(3) of the CISG provides that a party suspending performance must immediately give notice of the suspension to the other party and must continue with performance if the other party provides adequate assurance of his performance. CISG, *supra* note 56, art. 71(3).

103. FECL, *supra* note 52, art. 18.

104. *Id.* art. 19; CC, *supra* note 77, art. 112; SCR, *supra* note 72, art. 6(1). Article 74 of the CISG includes similar language, but it expressly states that lost profits may be included. CISG, *supra* note 56, art. 74.

attempting to minimize losses, or benefits that would have been received had the contract been implemented.<sup>105</sup>

Parties may agree upon liquidated damages and other measures of damages. If actual losses vary from those agreed upon, the parties may request an arbitration body or a court to adjust the amount appropriately.<sup>106</sup> Where both parties are in breach, each party bears its corresponding liabilities<sup>107</sup> and is civilly liable.<sup>108</sup> Any penalty amount agreed to by the parties must reflect a fixed compensation fund. If one party breaches the contract, it must pay the other the fixed penalty amount.<sup>109</sup>

Where a party suffers loss due to a breach, that party should take steps to minimize damages. Failure to do so will prevent claims for losses which may have been avoided by mitigation.<sup>110</sup> If a party fails to pay timely damages agreed upon or as specified in the contract, the aggrieved party is entitled to interest on the arrearages.<sup>111</sup>

## 8. *Force Majeure*

Without providing examples of what may constitute a *force majeure* event, the FECL merely states that a *force majeure* event is an objective situation that the parties cannot foresee at the time of contracting; its occurrence and effect cannot be avoided or overcome.<sup>112</sup> Thus, a *force majeure* event must meet two conditions: (1) it must have been unforeseen; and (2) it must be insurmountable.

If a *force majeure* event arises, it partially or fully exempts a party from performing its obligations under the contract. If a party is unable to fulfill its obligations in a timely manner due to a *force majeure* event, it is relieved of liability for delayed performance

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105. SCR, *supra* note 72, art. 6(1).

106. FECL, *supra* note 52, art. 20; SCR, *supra* note 72, art. 6(2).

107. FECL, *supra* note 52, art. 21. This is in accord with Article 132 of the Civil Code. See *supra* note 91 and accompanying text.

108. CC, *supra* note 77, art. 113.

109. SCR, *supra* note 72, art. 6(2).

110. FECL, *supra* note 52, art. 22; CC, *supra* note 77, art. 114. Article 77 of the CISG imposes a similar obligation to minimize damages. CISG, *supra* note 56, art. 77.

111. FECL, *supra* note 52, art. 23.

112. CC, *supra* note 77, art. 153; FECL, *supra* note 52, art. 24. See generally Timothy Gelatt & Laurence Bates, *Force Majeure, Termination, and Dispute Resolution: Contract Issues with a New Relevance*, E. ASIAN EXECUTIVE REP., July 1989, at 9. The CISG does not specifically address *force majeure*; rather, Article 79 of the CISG speaks in similar language of impediments beyond a party's control. CISG, *supra* note 56, art. 77.

over the period affected. Contracts may specify the scope of *force majeure* events.<sup>113</sup>

Parties prevented from performing their obligations due to a *force majeure* event should request that the other party mitigate its damages, and they should provide a certificate from a relevant authority within a reasonable period.<sup>114</sup> If a *force majeure* event prevents a party from performing its obligations or causes loss to a third party, the party is not civilly liable unless the law provides otherwise.<sup>115</sup>

If a party cannot perform its obligations as a result of some action taken by a higher authority, that party must compensate the other party for losses suffered in accordance with the contract. The higher authority, in turn, is responsible for reimbursing the loss.<sup>116</sup>

### 9. Assignment of Contracts

Both the FECL and the Civil Code allow for assignment of contracts. A party intending to assign a contract, however, must obtain consent from the other parties<sup>117</sup> and may not benefit from the assignment.<sup>118</sup> The FECL suggests that assignment of contracts formed under the approval of a competent authority remain subject to that authority, except in the case of preapproved contracts where it is otherwise agreed.<sup>119</sup> The Civil Code's standards are more stringent, requiring approval from the original authority, except where a law or a contractual provision allows otherwise.<sup>120</sup>

### 10. Modification, Cancellation, and Termination of Contracts

The FECL also permits contract modification, but only after consultation between the parties.<sup>121</sup> A contracting party may no-

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113. FECL, *supra* note 52, art. 24. In fact, these events should be anticipated or described in the contract, as far as reasonably possible.

114. *Id.* art. 25. It is not clear what would happen should the relevant authorities refuse to give such a certificate.

115. CC, *supra* note 77, art. 107.

116. *Id.* art. 116.

117. FECL, *supra* note 52, art. 26; CC, *supra* note 77, art. 91.

118. CC, *supra* note 77, art. 91. This is a curious provision in that no indication is given as to what is meant by "benefit."

119. FECL, *supra* note 52, art. 27.

120. CC, *supra* note 77, art. 91.

121. FECL, *supra* note 52, art. 28. *See also* CC, *supra* note 77, art. 88. Article 29(1) of the CISG provides that a contract may be modified or terminated by mere agreement of the parties. CISG, *supra* note 56, art. 29(1).

tify the other party that the contract is cancelled under any of the following circumstances: (1) its expected economic interests are seriously impaired by the other party's breach; (2) the other party fails to perform the contract timely and fails further to perform within a reasonable "delayed performance" time; (3) the entire contract is frustrated due to a *force majeure* event; or (4) agreed-upon cancellation conditions arise.<sup>122</sup> Where a contract contains several independent parts, cancellation of some provisions does not invalidate the entire contract.<sup>123</sup>

A contract terminates under three circumstances: (1) where the contract is performed as agreed; (2) where a court or an arbitral body terminates it; or (3) where the parties jointly agree to terminate it.<sup>124</sup>

Notice or agreement to modify or cancel a contract must be in writing.<sup>125</sup> Furthermore, significant contract modification requires approval by a competent state authority, and cancellation of a contract must be filed with this authority.<sup>126</sup> Contract modification, cancellation, or termination does not deprive a party of the right to claim damages<sup>127</sup> or compensation.<sup>128</sup> Moreover, terms relating to the settlement of disputes, accounts, or wind-up operations will not be invalidated by the cancellation or termination of the contract.<sup>129</sup>

## 11. Dispute Settlement

China, like many Asian nations, is adverse to litigation and only utilizes its court system as a last resort. Thus, the FECL provides that contract disputes are to be settled by the parties through consultation or third-party mediation whenever possible. If the parties are unwilling or fail to resolve a dispute through consultation or mediation, the dispute is then submitted to a Chinese or

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122. FECL, *supra* note 52, art. 29. For a further discussion of contract termination, see generally Gelatt & Bates, *supra* note 112.

123. FECL, *supra* note 52, art. 30.

124. *Id.* art. 31.

125. *Id.* art. 32. Article 29(2) of the CISG provides that a written contract that calls for modifications or terminations to be in writing may not otherwise be modified or terminated by agreement. CISG, *supra* note 56, art. 29(2).

126. FECL, *supra* note 52, art. 33.

127. *Id.* art. 34.

128. CC, *supra* note 77, art. 115.

129. FECL, *supra* note 52, arts. 35, 36.

foreign arbitration body pursuant to an arbitration clause contained in the contract or one agreed upon in writing.<sup>130</sup>

If the contract contains no arbitration clause and no written arbitration agreement is reached subsequently, the parties may initiate suit in the People's Court.<sup>131</sup> The term "dispute" is understood in its general sense. It includes disputes over matters such as the existence of a contract, the time of its making, and issues pertaining to contract interpretation, implementation, licensing, assignment, breach, suspension, or termination.<sup>132</sup>

## 12. Choice of Law

The FECL, the Civil Code, and the Supreme People's Court have all addressed choice of law issues. Thus, when China is a signatory to an international treaty related to a contract where treaty provisions conflict with Chinese law, the terms of the treaty control, unless they cover a topic in which China has declared reservations.<sup>133</sup> As a signatory to the CISG, China applies the CISG to international contracts for the sale of goods unless the parties choose different law.<sup>134</sup>

Chinese law applies to contracts involving Chinese-foreign joint equity and cooperative ventures and to those involving Chinese-foreign cooperative exploitation and development of natural resources that are performed within Chinese territory.<sup>135</sup> Any

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130. *Id.* art. 37. On December 30, 1990, the State Council approved Provisional Regulations on the Administration of Arbitral Bodies for Technology Contracts, effective January 21, 1991. See 2 Bus. Reg. China L. Foreign Bus. (CCH) ¶ 10-640 (1993). The purpose of the Regulations is to improve the administration of arbitral organs for technology contract disputes, protect concerned parties' legitimate rights and interests, and maintain order in the technology market. *Id.*

131. FECL, *supra* note 52, art. 38. For a discussion of how and when to go to court, see Richard J. Goosen, Esq., *When To Enforce Contractual Rights in China*, E. ASIAN EXECUTIVE REP., Apr. 1986, at 8. Although dated, the observations made therein are still relevant. Additionally, in August 1993, a special Intellectual Property Court was established under the Beijing Intermediate People's Court to handle intellectual property rights disputes exclusively. For a further account, see *New Court Hears First Patent Case*, CHINA DAILY, Aug. 28, 1993, at 3.

132. SCR, *supra* note 72, art. 2(1).

133. FECL, *supra* note 52, art. 6; CC, *supra* note 77, art. 142; SCR, *supra* note 72, art. 2(8).

134. For a discussion of CISG provisions that conflict with or complement Chinese law, see CISG, *supra* note 56.

135. FECL, *supra* note 52, art. 5; SCR, *supra* note 72, art. 2(2).

clause purporting to subject any such ventures to foreign law is invalid.<sup>136</sup>

Except where the law provides otherwise, the FECL, the Civil Code, and the Supreme People's Court all provide, with respect to other types of contracts, that contracting parties may choose the law applicable to any dispute that may arise. In the absence of such a choice, however, or where the parties cannot agree upon a choice, the law of the country most closely related to the contract applies.<sup>137</sup>

### 13. "Closest Relationship" for Certain Foreign Economic Contracts

The parties may choose the applicable law for settling disputes upon signing the contract or after a dispute arises, and the People's Court will apply the chosen law in settling disputes as long as the parties' decision is unanimous and unequivocal.<sup>138</sup> Where the Court itself determines which law to apply, unless the contract is clearly related to the law of another country or region, the Court will choose the applicable law in the following manner:

1. For international commodity trade contracts, the Court will apply the law of the region where the seller's operational base lies at the time of the signing. If the contract was negotiated and signed at the buyer's operational base, or if the buyer decided its main clauses and concluded it after calling for tenders, or if it clearly directs delivery to the buyer's operational base, the Court will apply the law of the region where the operational base lies.
2. For bank-loan or guarantee contracts, the Court will apply the law of the region where the bank is located.
3. For insurance contracts, the Court will apply the law of the region where the insurer's operational base lies.
4. For work processing contracts, the Court will apply the law of the region where the processor is located.

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136. SCR, *supra* note 72, art. 2(3).

137. FECL, *supra* note 52, art. 6; CC, *supra* note 77, art. 145; SCR, *supra* note 72, art. 2(4). These provisions also accord with the CISG, which permits parties to make their own choices of law. CISG, *supra* note 56, arts. 6, 9.

138. SCR, *supra* note 72, art. 2(2).

5. For technology transfer contracts, the Court will apply the law of the region where the assignee's operational base lies.
6. For project tender contracts, the Court will apply the law of the region where the project is located.
7. For scientific or technical consulting contracts, the Court will apply the law of the region where the client's operational base lies.
8. For labor contracts, the Court will apply the law of the region where the labor services are to be performed.
9. For contracts for the supply of complete sets of equipment, the Court will apply the law of the region where the equipment is transported and installed.
10. For agency contracts, the Court will apply the law of the region where the agent's operational base lies.
11. For contracts for lease, purchase, sale, or mortgage of real estate, the Court will apply the law of the real estate's situs.
12. For contracts for the leasing of movable property, the Court will apply the law of the region where the lessor's operational base lies.
13. For storage and custody contracts, the Court will apply the law of the region where the storage and custody unit's operational base is located.<sup>139</sup>

If the party has more than one operational base, the base which most closely concerns the contract is selected. If there is no operational base, the parties' domicile or actual residence is selected.<sup>140</sup>

The law chosen for dispute settlement is the law currently in effect, excluding conflicts of law or procedural law.<sup>141</sup> If the Court cannot interpret foreign law, it ascertains an interpretation from the parties, the Chinese embassy or consulate located in the country whose law is in question, the foreign embassy or consulate of the country whose law is in question, or an expert in Chinese-for-

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139. *Id.* art. 2(6). Article 10 of the CISG also provides that, if a party has more than one place of business, the business with the closest relationship to the contract and performance will be used. The CISG, however, does not describe how to determine which place of business has the "closest relationship." CISG, *supra* note 56, art. 10.

140. SCR, *supra* note 72, art. 2(7).

141. *Id.* art. 2(5).

eign law. If the law in question still is not ascertained, the matter is decided according to corresponding Chinese law.<sup>142</sup> Where Chinese law is silent on a subject, international law applies.<sup>143</sup>

Where Chinese law applies, but Chinese authorities have not ruled on the issue, international practice may apply.<sup>144</sup> Where foreign law applies, but that law is repugnant to fundamental principles of Chinese law or public interest, appropriate Chinese law applies instead.<sup>145</sup>

#### 14. Statutes of Limitations

The Civil Code provides that the statute of limitations for bringing actions in the People's Court to protect civil rights is two years, unless the law provides otherwise.<sup>146</sup> A cause of action accrues from the time a party knew or should have known that its rights have been infringed.<sup>147</sup> The FECL provides that the statute of limitations for litigation or arbitration on contracts for the purchase and sale of goods is four years from the time the party knew or should have known that its rights have been violated. Statutes of limitation for other contracts are stipulated separately by law.<sup>148</sup> The Civil Code, for example, allows actions for the sale of substandard merchandise or the loss or damage to bailment property to be brought within one year.<sup>149</sup> If more than twenty years have elapsed from the time the party knew or should have known that its rights had been infringed, the Court will not enforce

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142. *Id.* art. 2(11)(i)-(iv).

143. FECL, *supra* note 52, art. 5; CC, *supra* note 77, art. 142.

144. SCR, *supra* note 72, art. 2(9).

145. *Id.* art. 2(10). For example, Article 11 of the CISG discloses that contracts for sale need not be in writing. CISG, *supra* note 56, art. 11. China opted out of this provision. In fact, the Supreme People's Court expressly declared that foreign economic contracts that are not in writing are void. SCR, *supra* note 72, art. 3(i)-(ix). The Shenzhen Import Regulation, the Xiamen Import Regulation, and the Guangzhou Import Regulation all require written contracts. See Shenzhen Import Regulation, *supra* note 47, art. 84; Xiamen Import Regulation, *supra* note 50, art. 7; Guangzhou Import Regulation, *supra* note 51, art. 4.

146. CC, *supra* note 77, art. 135.

147. *Id.* art. 137.

148. FECL, *supra* note 52, art. 39. In regard to delivery of non-conforming goods, Article 39(2) of the CISG provides that a buyer loses the right to rely on lack of conformity as a breach of contract if he does not give the seller notice thereof within a period of two years from the date on which the goods were actually handed over to the buyer, unless that time limit is inconsistent with a contractual period of guarantee. CISG, *supra* note 56, art. 39(2).

149. CC, *supra* note 77, art. 136.



those rights unless it extends the period due to exceptional circumstances.<sup>150</sup>

China computes time limits by the Gregorian Calendar in years, months, days, and hours. If set in days, months, or years, the period begins to run the day after the occurrence of the event giving rise to its start. In all other cases, it will begin immediately. If the last day of the statute of limitations falls on either Sunday or a legal holiday, the statute runs until the following day. The last day terminates at 24:00 hours unless business hours are referenced, in which case it ends at the close of business activities.<sup>151</sup>

Where the law adds provisions, contracts approved by a competent authority that involve either (1) Chinese-foreign joint ventures or (2) Chinese-foreign exploitation of natural resources performed within a Chinese territory may be performed according to their terms.<sup>152</sup> Even where the statute of limitations has run, the parties may fulfill the terms of the contract and are not bound by the limitations restriction.<sup>153</sup>

A statute of limitation is tolled if, during the six months before it runs, a *force majeure* event prevents a party from filing a timely complaint. In this case, the statute tolls during the pendency of the *force majeure* event and resumes on the day the event ends.<sup>154</sup> The statute of limitations tolls upon the filing of a complaint or when the parties raise requests or agree to perform the obligations. At this time, a new statute of limitations begins to run.<sup>155</sup> Where the law provides other statutes of limitations, those periods apply.<sup>156</sup>

## 15. Invalidation and Revocation of Foreign Economic Contracts

A foreign economic contract is invalidated under the following circumstances:

1. A contracting party lacks legal principal status.
2. The Chinese party conducting business operations with foreigners lacks approval by the state organ in charge.

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150. *Id.* art. 137.

151. *Id.* art. 154.

152. FECL, *supra* note 52, art. 40.

153. CC, *supra* note 77, art. 138. Article 45(3) of the CISG provides that no period of grace is granted to the seller by a court or an arbitral tribunal when the buyer resorts to a remedy for breach of contract. CISG, *supra* note 56, art. 45(3).

154. CC, *supra* note 77, art. 139.

155. *Id.* art. 140.

156. *Id.* art. 141.

3. The Chinese party exceeds its approved scope of operations.
4. An agent signs a contract in the name of a party it purportedly represents, the agent exceeds his or her scope of authority, or the agent's authority has ended and the principal neither ratifies the agent's actions nor immediately disavows them upon learning of them.
5. The contract is not in writing.
6. The contract, major amendments thereto, or an assignment thereof requires approval of a state organ but such approval has not yet been given.
7. One party uses deceptive or coercive methods to mislead or force the other party to sign a contract containing unjust provisions.
8. Two parties, with ill intent, conspire to sign a contract adverse to the interests of the state, or a collective or a third party, or otherwise use legal means to achieve illegal goals.
9. The contents of a contract violate fundamental principles of Chinese law or Chinese public interest.<sup>157</sup>

A contracting party may request the court to revoke a foreign economic contract where there is a vital misunderstanding over its contents after signing or where the contract has clearly lost its impartiality. A contract which is revoked is void *ab initio*.<sup>158</sup>

If only part of a contract is invalidated, or the parties themselves decide to strike an invalid clause, but the validity of the remainder of the contract is not affected, the unaffected part of the contract remains valid.<sup>159</sup> If a contract is invalidated or revoked due to the fault of one of the contracting parties, the culpable party

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157. SCR, *supra* note 72, art. 3(i)-(ix). While none of the local import rules describe circumstances under which a contract will be invalidated, the Guangzhou Import Regulation, the Xiamen Import Regulation, and the Shenzhen Import Regulation all proscribe unreasonable provisions in contracts, implying that the provisions will be invalid. See Shenzhen Import Regulation, *supra* note 47, art. 18; Xiamen Import Regulation, *supra* note 50, art. 9; Guangzhan Import Regulation, *supra* note 51, art. 20. The Xiamen Import Regulation specifically states that the import of technology that harms the public order, violates social ethics, undermines the ecological balance, or harms the environment is forbidden. Xiamen Import Regulation, *supra* note 50, art. 9.

158. SCR, *supra* note 72, art. 4.

159. *Id.* art. 5(1).

will be liable to compensate the other for losses sustained as a result of the invalidation or revocation.<sup>160</sup>

If both parties conspire, with ill intent, to enter a contract with an objective that is repugnant to state law, public interest, or the interests of a third party, any gains realized by the colluding parties are returned to the state or to the third party. Furthermore, the court may reprimand, fine, or detain the offending party, depending upon the seriousness of the case. If the matter involves an economic crime, it is turned over to the public security, investigating, and prosecuting organs for further handling.<sup>161</sup>

#### IV. TECHNOLOGY IMPORT REGULATIONS AND IMPLEMENTING RULES

The ICAR became effective when it was promulgated in 1985.<sup>162</sup> Consisting of only thirteen articles, the ICAR is relatively brief and straightforward. The ICAR's stated objectives are as follows: (1) to expand further economic and technical cooperation between foreign countries and China; (2) to raise China's level of science and technology; and (3) to promote China's national economy.<sup>163</sup> MOFERT is responsible for interpreting the ICAR and for formulating rules of implementation.<sup>164</sup> The ICARIR consists of twenty-six articles, enacted as directed by the ICAR<sup>165</sup> and effective on the date of promulgation.<sup>166</sup> MOFERT is also responsible for interpretation and amendment of the ICARIR.<sup>167</sup>

The technology import discussed in the Regulations refers to technology acquisition by companies, enterprises, organizations, or individuals within China (recipients) from similar entities or individuals outside of China (suppliers). These transactions occur through trade channels or through economic and technical cooperation. They include: (1) the assignment or licensing of patent or

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160. *Id.* art. 5(2).

161. *Id.* art. 5(3).

162. ICAR, *supra* note 53, art. 13. The ICAR was closely modeled after the United Nations Conference on Trade and Development ("UNCTAD") and the Draft International Code of Conduct on the Transfer of Technology ("UNCTAD Draft Code"), embodying commonly-accepted technology import rules. CHENGSI & PENDLETON, *supra* note 3, at 155-58. For a comparison of the UNCTAD Draft Code with the ICAR, see *id.*

163. ICAR, *supra* note 53, art. 1.

164. *Id.* art. 12. See MOFERT's *New Look*, *supra* note 59.

165. ICARIR, *supra* note 54, art. 1.

166. *Id.* art. 26.

167. *Id.* art. 25.

other industrial property rights; (2) production processes, formulae, product designs, quality control, and management skill, as expressed in drawings, technical data, and specifications; and (3) technical services.<sup>168</sup>

### A. Technology Capable of Import

China will not import technology merely because it is inexpensive or easily available. Rather, the technology must be advanced, appropriate, and able to achieve one or more of the following goals: (1) develop and produce new products; (2) raise a product's quality and performance or reduce production costs; (3) further the full use of China's natural resources; (4) expand product exports and generate foreign exchange revenue; (5) advance environmental protection, safety in production, or management and administration improvement; (6) facilitate production safety; (7) improve management; or (8) help raise scientific and technological levels.<sup>169</sup>

### B. Application and Approval Procedure

The ICAR requires both the recipient and the supplier to sign a written technology import contract. Furthermore, within thirty days of the signing, the recipient must submit an application to MOFERT or another authority for examination and approval. Approval or rejection is given within sixty days of receipt. If neither approval nor rejection is given within that time, the contract will be considered approved and will automatically come into force.<sup>170</sup> The obligatory documents include an application for contract approval, a duplicate and a translation of the contract, photocopies of documents certifying the parties' legal status, an approved feasibility

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168. ICAR, *supra* note 53, art. 2.

169. *Id.* art. 3. See generally Chang & Pow, *supra* note 81, at 8. Satisfying any one of these conditions will suffice. The Shenzhen Import Regulation and the Guangzhou Import Regulation demand that technology be appropriate, advanced, and show obvious economic performance. Shenzhen Import Regulation, *supra* note 47, art. 5; Guangzhou Import Regulation, *supra* note 50, art. 5. The Xiamen Import Regulation demands that technology be practical and advanced, with marked economic benefits. Xiamen Import Regulation, *supra* note 50, art. 3. Only the Guangzhou Import Regulation defines the terms "advanced," "appropriate," and "with obvious economic performance." Guangzhou Import Regulation, *supra* note 51, art. 3.

170. ICAR, *supra* note 53, art. 4.

ity study, and financing details.<sup>171</sup> Contract modifications or extensions of its term are handled similarly.<sup>172</sup>

Applications for examination and approval of technology import contracts are submitted to the authorities regardless of the supplier's country of origin or the recipient's source of funds or method of repayment. Contracts requiring submission for approval include those that:

1. Assign or license industrial rights.
2. License proprietary technology, including those that supply knowledge of a product's manufacture or the application of a certain technique, product design, technological process, formula, or quality control not made public and not protected by industrial property rights law.
3. Provide technical service, including those where the supplier provides the recipient services or advice to help it reach specific goals, where a supplier carries out part or all of a feasibility study, where a foreign geological exploration or engineering team provides technical services, or where a supplier provides services or advice on an enterprise's technological transformation, production technology improvement, product design, quality control, or enterprise management. Excluded are those contracts where foreigners assume posts in Chinese enterprises.
4. Provide for cooperative production or design, including contracts assigning or licensing industrial rights, proprietary knowledge, or provisions of technical services.
5. Provide for the importation of complete sets of equipment and production lines, including assigning or licensing industrial property rights, proprietary technology, or technical services.
6. Provide for examination and approval authority orders.<sup>173</sup>

A contract is effective on the date of approval, at which time the examination and approval authority issues a Technology Im-

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171. *Id.* art. 10; ICARIR, *supra* note 54, art. 17. The documentation required under the Guangzhou Import Regulation and the Shenzhen Import Regulation are similar. Shenzhen Import Regulation, *supra* note 47, art. 15; Guangzhou Import Regulation, *supra* note 51, art. 27. The Xiamen Import Regulation, however, only appears to require the submission of a letter of intent and a feasibility study. Xiamen Import Regulation, *supra* note 50, art. 7.

172. ICAR, *supra* note 53, art. 11.

173. ICARIR, *supra* note 54, art. 2(i)-(vi).

port Contract Approval Certificate, which MOFERT prints and numbers.<sup>174</sup> When the term of a technology contract exceeds ten years or contains questionably restrictive provisions, the recipient submits a detailed explanation for the time-frame to the examination and approval authority.<sup>175</sup>

### C. Examination and Approval Authorities

To prevent Chinese entities from contracting to acquire outdated technology or from being victimized by unfair or restrictive business practices, China examines and approves technology import contracts at different levels, depending on whether feasibility studies are approved and on the project's location and purpose.

In addition to MOFERT, the ultimate examination and approval authority, China permits other organs to examine and approve technology import contracts. These include the offices, commissions, and bureaus of foreign economic relation and trade of the provinces, autonomous regions, municipalities directly under the central government, Special Economic Zones and municipalities with separate development plans authorized by MOFERT, and other control authorities authorized by MOFERT.<sup>176</sup>

Contracts relating to projects where feasibility studies are approved by the State Council ministry or commission must be ex-

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174. *Id.* art. 20. For a discussion of how the decision-making process works and how confusing it may be, see *Technology Transfer to China: The Decision Making Process*, E. ASIAN EXECUTIVE REP., Dec. 1987, at 7.

175. ICARIR, *supra* note 54, art. 21. See Preston M. Torbert, *Technology Transfer to China Under the New Regulations*, E. ASIAN EXECUTIVE REP., Sept. 1985, at 8 (noting that few contracts with terms of more than ten years are approved and that, when they are, it is usually to give the Chinese parties time to master the technology, especially where trademarks are issued). The Xiamen Import Regulation does not limit technology import contract duration; however, the Shenzhen Import Regulation limits it to five years, except when the technology is invested as capital stock. The Guangzhou Import Regulation limits contract duration to the time required for the recipient to master the technology, generally not to exceed ten years. *Id.*

176. ICARIR, *supra* note 54, art. 6. For thoughts on technology transfer approval, see *Technology Transfer to China: The Decision Making Process*, *supra* note 174. The examination and approval process becomes cloudier because of MOFERT's change into MOFTEC and the several new bureaus it created. See *MOFERT's New Look*, *supra* note 59, at 38-39. Under the Shenzhen Import Regulation, the Shenzhen Municipal People's Government is the approval authority of the first instance. Shenzhen Import Regulation, *supra* note 47, art. 15. Under the Xiamen Import Regulation, applicants must apply to an organ authorized by the Xiamen Municipal People's Government. Xiamen Import Regulation, *supra* note 50, art. 27. Under the Guangzhou Import Regulation, the Guangzhou Development Zone Administrative Commission is the approval authority of first instance. Guangzhou Import Regulation, *supra* note 51, art. 27.

amined and approved by MOFERT. Contracts relating to projects where feasibility studies are approved by the People's Governments or their authorized organs, provinces, autonomous regions, municipalities, open coastal cities, or Special Economic Zones are examined and approved by the authorities of those respective levels. Where those contracts are signed by an entrusted company in a different region, they are examined and approved by the authority in that region with the consent of the authority at the principal's location. Once approved, the examination and approval authority at the site of the signing delivers a photocopy of the document approving the contract to the authorized examination and approval authority at the principal's site. Where companies in other regions entrust Beijing-based companies to enter technology import contracts with foreigners, those contracts are examined and approved by MOFERT.<sup>177</sup>

Contracts entered into by FEIs established for the purpose of obtaining technology are examined by MOFERT if the FEI is approved by either a State Council ministry or commission, by departments of ministries directly subordinate to them, or by another examination and approval authority.<sup>178</sup>

Where companies, enterprises, or individuals lack the authority to import the desired technology themselves, they must do so through entities that have such authority. This is accomplished through powers of attorney.<sup>179</sup>

Technology contracts entered into by Chinese-foreign equity, and cooperative joint ventures and foreign-owned ventures established within China for the purpose of obtaining technology from suppliers, are subject to examination and approval according to these rules. Where foreign investors of the FEIs contribute industrial property rights or proprietary technology, such investments are governed by China's laws and regulations on FEIs.<sup>180</sup>

Technology import contracts involving the assignment or licensing of patent or trademark rights obtained in China must indicate the relevant patent number (application number) or trademark registration and provide a sample copy thereof. Where the contract involves a patent assignment, the contracting parties

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177. ICARIR, *supra* note 54, art. 6(ii).

178. *Id.* art. 6(iii).

179. *Id.* art. 3.

180. *Id.* art. 4. It is clear that, in these instances, the CISG would not apply.

submit the required items to the patent office for recording under China's Patent Law. Where trademark licensing is involved, submission is made to the Trademark Bureau for recording under the Trademark Law.<sup>181</sup>

#### *D. Unacceptable Technology Import Contracts*

In some circumstances, China may deem technology import contracts less acceptable as a matter of public policy. Thus, contracts are closely examined and approval is not granted if the provisions:

1. Are repugnant to state laws or regulations then in effect and/or are repugnant to the public interest.
2. Harm state sovereignty.
3. Are inconsistent with the project's approved feasibility study.
4. Are uncertain.
5. Do not expressly and reasonably cover liability for, and settlement of, property right disputes over the assigned or licensed technology.
6. Do not reasonably describe the technical level and the economic benefits sought by the technology, or which warrant the quality of the products produced with the technology.
7. Contain inappropriate prices or methods of payment for the imported technology.
8. Are insufficiently certain, reciprocal, or reasonable with respect to the contracting parties' rights, responsibilities, and obligations.
9. Promise tax concessions to which tax authorities have not agreed.<sup>182</sup>

Where a contract is rejected, the parties are given an opportunity to make corrections. If corrections are not made, the contract will be rejected.<sup>183</sup> The examination and approval authorities must

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181. *Id.* art. 8. The Guangzhou Import Regulation, the Xiamen Import Regulation, and the Shenzhen Import Regulation all have similar requirements. See Shenzhen Import Regulation, *supra* note 47, arts. 7, 8; Guangzhou Import Regulation, *supra* note 51, arts. 8, 9; Xiamen Import Regulation, *supra* note 50, art. 10.

182. ICARIR, *supra* note 54, art. 18(i)-(ix). It must be remembered that these factors will be closely scrutinized in addition to those contained in Article 12 of the FECL. See *supra* note 92 and accompanying text.

183. ICARIR, *supra* note 54, art. 18.



approve or reject the application within sixty days of receiving an application for approval. The time limit for examination and approval of contracts that are ordered amended is counted from the date the amendments are received. If the authorities do not respond by the end of the time period, the contracts are deemed to have been approved.<sup>184</sup>

Authorized examination and approval authorities must, within ten days of its approval, submit a photocopy of the Technology Import Contract Approval Certificate and other relevant information to MOFERT for the record.<sup>185</sup> When implementing technology import contracts and pursuing such matters as bank guarantees, letters of credit, payments, foreign exchange settlements, customs declarations, and duty and tax payments, the contracting parties must present the Technology Import Contract Approval Certificate. Where such certificates are not presented, banks, customs, and tax authorities may refuse to handle the matter.<sup>186</sup>

#### *E. Obligatory Matters Under the ICAR and ICARIR*

Many matters addressed under a technology import contract are similar to those addressed under the FECL, where provisions and relevant laws are observed in signing technology import contracts. Thus, in addition to complying with the FECL,<sup>187</sup> technology import contracts must also address the following matters:

1. The contract's title.
2. The content, scope, and description of the imported technology, including a list of all relevant patents and trademarks.
3. The expected technical objectives and the time periods within which such objectives will be met.
4. Criteria, time limits, and methods for evaluating whether the imported technology's objectives are met, and the apportionment of risk liability.

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184. *Id.* art. 19. See Owen D. Nee, Esq., *The Foreign Economic Contracts Law: Practice Commentary*, in COMMERCIAL, BUSINESS AND TRADE LAWS 1-5 (1991) (noting that there are no mute approvals, as all approved contracts must have an approval certificate, in the absence of which banking, customs, and tax authorities may reject payments or remittances). See ICARIR, *supra* note 54, art. 24.

185. ICARIR, *supra* note 54, art. 23.

186. *Id.* art. 24.

187. FECL, *supra* note 52, art. 12.

5. Confidential matters regarding the technology and the ownership and sharing of improvements to it.
6. Price and method of payment.
7. Method for calculating liquidated damages.
8. Method for resolving disputes.
9. Definition of technical terms.<sup>188</sup>

### F. Supplier Warranties

Both the ICAR and the ICARIR require the supplier to warrant that the technology or documentary information it provides is complete, accurate, effective, and capable of achieving the contract's technical objective. The delivery times for technical documents must meet the scheduled progress of the recipient's project.<sup>189</sup> Where suppliers must provide raw materials, parts, components, or equipment for the recipients, their prices may not exceed the international market price for the same product.<sup>190</sup>

Suppliers must warrant that they are the legal owners of the technology provided or that they have the right to assign or license it. Where third parties accuse the recipients of infringing upon their rights by producing or selling products with the assigned or licensed technology, the supplier is responsible for responding to the suit. If the third party claim is substantiated, the supplier must indemnify the recipient for its financial loss.<sup>191</sup>

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188. ICAR, *supra* note 53, art. 5; ICARIR, *supra* note 54, art. 7. It must be noted that, under the ICAR and the ICARIR, the supplier is not required to train the recipient in the use of the technology. In practice, however, Chinese buyers often insist that personnel train them in the use and application of the technology they purchase. The Xiamen Import Regulation and the Shenzhen Import Regulation specifically require the supplier to train recipient personnel in the use of the technology. Xiamen Import Regulation, *supra* note 50, art. 11; Shenzhen Import Regulation, *supra* note 47, art. 10. The Guangzhou Import Regulation requires such training by stating that provisions be included in technology contracts giving plans for technical training. Guangzhou Import Regulation, *supra* note 51, arts. 14, 15.

189. ICAR, *supra* note 53, art. 6; ICARIR, *supra* note 54, art. 9. Article 24 of the Guangzhou Import Regulation requires the supplier to guarantee the recipient's ability to master the technology. Guangzhou Import Regulation, *supra* note 51, art. 24. Article 11 of the Xiamen Import Regulation and Article 10 of the Shenzhen Import Regulation require the supplier to train recipient personnel to ensure the technology is understood. Xiamen Import Regulation, *supra* note 50, art. 11; Shenzhen Import Regulation, *supra* note 47, art. 10.

190. ICARIR, *supra* note 54, art. 10.

191. *Id.* art. 11. The Xiamen Import Regulation, the Guangzhou Import Regulation, and the Shenzhen Import Regulation all have similar language imposing supplier liability for losses. In fact, the Shenzhen Import Regulation demands that products manufactured with

### G. Ownership of Improvements

During the effective term of the contract, ownership of improvements to the technology, including patent rights, belongs to the party making the improvements. The terms granting ownership of improvements to the technology to the supplier are the same as those on which the supplier provides improvements to the technology.<sup>192</sup>

### H. Proscribed Provisions

Many countries closely scrutinize contract provisions dealing with grant-back provisions, restrictions after expiration of industrial property rights, no-challenge provisions, tie-ins, appointment of personnel, non-competition, restrictions on research and development, use of competing technology, price-fixing, export restrictions, field-of-use restrictions, exclusivity, territorial restrictions, production and volume requirements, quality control, and excessive duration.<sup>193</sup> In addition to finding a technology import contract objectionable on public policy grounds, China does not sanction foreign suppliers who subject Chinese recipients to restrictions considered unreasonable. Thus, without special approval, a technology import contract may not do any of the following:

1. Require the recipient to accept supplemental conditions unrelated to the technology import, including the purchase of needless technology, technical services, raw materials, equipment, or products.
2. Restrict the recipient's freedom of choice to buy raw materials or spare parts from sources other than the supplier.<sup>194</sup>

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the imported technology have reasonable sales on the international market, and impose responsibility on the supplier for any losses in product sales. Shenzhen Import Regulation, *supra* note 47, art. 12. The later Guangzhou Import Regulation, the Xiamen Import Regulation, ICAR, and ICARIR do not impose such a responsibility on the supplier. Guangzhou Import Regulation, *supra* note 51, art. 23; Xiamen Import Regulation, *supra* note 50, art. 13.

192. ICARIR, *supra* note 54, art. 12.

193. For a discussion of these various restrictions, see generally BLAKENEY, *supra* note 3, at 35-41.

194. ICARIR, *supra* note 54, art. 9. One problem this restriction creates is that, where the supplier must guarantee that certain technical objectives are met or that the recipient master the imported technology; or if the recipient purchases substandard supplies or spare parts, the contract's objectives might be jeopardized. See Torbert, *supra* note 175, at 8.

3. Restrict the recipient from developing or improving upon the technology.
4. Restrict the recipient from acquiring similar or competitive technology from other sources.
5. Impose unequal conditions for the parties' exchange of technical improvements.
6. Restrict the volume, variety, or sale price of products produced by the technology.
7. Limit unreasonably the recipient's sales channels or export markets.
8. Ban the recipient's continued use of the technology beyond the expiration of the contract term.
9. Bind the recipient to buy unusable or invalid patents.<sup>195</sup>

Without the approval of the examination and approval authorities, contracts may not restrict the recipient's exportation of products that use the imported technology, except to countries or regions where the supplier entered into exclusive licensing or agency contracts.<sup>196</sup>

Without approval, contracts may not restrict the recipient's use of the technology after the contract terminates. If the term of the patent has not expired at the end of a contract, matters are handled in accordance with relevant provisions of China's Patent Law.<sup>197</sup>

### I. Taxation

While the ICAR is silent on the subject of taxation, the Implementing Rules obligate suppliers to comply with China's tax laws.<sup>198</sup> Under the Foreign Investment Enterprise and Foreign Enterprise Tax Law, technology transfers are usually subject to a twenty percent withholding tax on the gross sales price, provided

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195. ICAR, *supra* note 53, art. 9. Article 20 of the Guangzhou Import Regulation and Article 9 of the Xiamen Import Regulation contain similar proscriptions. Guangzhou Import Regulation, *supra* note 51, art. 20; Xiamen Import Regulation, *supra* note 50, art. 9. Article 18 of the Shenzhen Import Regulation simply states that unreasonable restrictions or unfair provisions are not imposed upon either party. Shenzhen Import Regulation, *supra* note 47, art. 18.

196. ICARIR, *supra* note 54, art. 14.

197. *Id.* art. 15. Generally, the provisions on restrictive trade practices are taken directly from the UNCTAD Draft Code. See CHENGSI & PENDLETON, *supra* note 3, at 155-58.

198. ICARIR, *supra* note 54, art. 16.

the seller has no business establishment in China.<sup>199</sup> Upon approval, income may be taxed at ten percent<sup>200</sup> or be fully exempt in some instances.<sup>201</sup>

### J. Confidentiality

Confidentiality of technological information provided to recipients remains a contested issue. To assuage any misgivings that foreign suppliers entertain, the ICAR requires recipients to maintain the confidentiality of the technology within the scope and time-period agreed upon in the contract.<sup>202</sup> This time-period, however, generally must not exceed the duration of the contract, except where special circumstances warrant it. Where there are special circumstances, such requirements must be specified in the contract and noted when applying for examination and approval.

If, during the period of confidentiality, technology is made public through no fault of the recipient, the recipient's obligation to maintain confidentiality automatically terminates. If suppliers are required to provide recipients with technological developments and improvements during the term of the contract, recipients may still be obligated to maintain the confidentiality of such developments and improvements when the contract expires. The term of confidentiality is calculated from the date on which the supplier provides the technology, improvement, or development, but may not exceed the term provided.<sup>203</sup> The contract's term must be long

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199. Foreign Investment Enterprise and Foreign Enterprise Tax Law of the P.R.C., Apr. 9, 1991, art. 19 (effective July 1, 1991) (translated in 5 CHINA L. & PRAC., Apr. 15, 1991, at 25) [hereinafter FEI Tax Law]; Foreign Investment Enterprise and Foreign Enterprise Tax Law of the PRC Implementing Rules, art. 66 (effective July 1, 1991) (translated in 5 CHINA L. & PRAC., Apr. 15, 1991, at 25) [hereinafter FEI Tax Law Implementing Rules].

200. FEI Tax Law, *supra* note 199, art. 19; FEI Tax Law Implementing Rules, *supra* note 199, art. 66. See also John T. Kuzmik, *Technology Transfer Vital Element in Foreign Investment*, ASIA L. & PRAC., Mar. 12, 1992, at 33.

201. FEI Tax Law, *supra* note 199, art. 19; FEI Tax Law Implementing Rules, *supra* note 199, art. 66.

202. The Shenzhen Import Regulation and the Guangzhou Import Regulation require the recipient to keep confidential secret portions of the technology and to compensate the supplier for losses caused by unauthorized disclosures. Shenzhen Import Regulation, *supra* note 47, art. 13; Guangzhou Import Regulation, *supra* note 51, art. 26. The Xiamen Import Regulation, however, requires the recipient to observe a contract's secrecy clause and to permit the supplier to withdraw its technology and terminate the contract in the event of unauthorized disclosure. Xiamen Import Regulation, *supra* note 50, art. 14.

203. ICAR, *supra* note 53, art. 7; ICARIR, *supra* note 54, art. 13.

enough to allow the recipient to master the imported technology, but may not exceed ten years without approval.<sup>204</sup>

If the transferred technology is patented or trademarked, registering the patent or the trademark may provide additional protection against later use of the technology by unauthorized third parties. Once registered, no entity or individual may make, use, or sell the patented product without authorization. Third parties, or products directly produced by them, may not import without authorization.<sup>205</sup> Similar protections exist for trademark<sup>206</sup> registration. This gives the product added protection beyond what may be agreed upon in the technology import contract where third parties have not been authorized therein to use a patented or trademarked product.<sup>207</sup> Unless the product is registered, it does not receive such added protection.<sup>208</sup>

### K. Amendments

With respect to the technology imported, its price, or the terms of confidentiality, amendments to approved technology import contracts require written consensus of all the contracting parties and written approval of the examination and approval authorities. If the amendment is inconsistent with the description of the technology imported, or exceeds the requisite amount of foreign exchange as originally approved, authorities repeat the examination and approval procedures as if approving it for the first time.<sup>209</sup>

## V. THE NEGOTIATING PROCESS

### A. Use of Standard Form Contracts

While a clear understanding of China's technology import regulations and the contract laws where they apply are prerequisite to any sensible business dealings with China, matters are facilitated considerably with the use by Chinese business entities of standard-form contracts where many contract matters are already ad-

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204. ICAR, *supra* note 53, art. 8.

205. Patent Law of the P.R.C., *supra* note 37, arts. 11, 12.

206. Trademark Law of the P.R.C., *supra* note 14, arts. 37-40.

207. ICARIR, *supra* note 54, art. 8.

208. Patent Law of the P.R.C., *supra* note 37, arts. 6, 9.

209. ICARIR, *supra* note 54, art. 22.

dressed.<sup>210</sup> As with any form contracts, however, they provide only a framework for negotiations and must be examined closely. The form provisions may be altered, deleted, or complemented through negotiations between the parties. Thus, familiarity with China's contract and technology transfer laws is still required.

The negotiation of price, payment, delivery terms and packing, inspection and acceptance, guarantees and claims, penalties, *force majeure*, technical training and personnel, patents and trademarks, and taxes are some of the more troublesome areas of negotiation.<sup>211</sup> Furthermore, although neither the ICAR nor the ICARIR requires technical support or training, Chinese negotiating teams often insist that such technical training is provided.<sup>212</sup> Moreover, problems often arise over acceptance tests.<sup>213</sup> While form provisions serve to aggregate many issues that often cause difficulties in contract negotiations, these and other matters simply are not resolved by the use of a form contract; they require thorough negotiation.

### B. Authority of Chinese Parties

Previously, China's foreign trade bureaucracy and its system for approving technology import contracts were always seen as uncoordinated and fractured.<sup>214</sup> Today, adding to the complexity of that system and of doing business with China generally, China's major foreign trade organ, MOFERT, has undergone a change and

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210. For a discussion of the use of standard-form contracts in China, see Preston M. Torbert, *Contract Law in the People's Republic of China*, in FOREIGN TRADE, INVESTMENT, AND THE LAW IN THE PEOPLE'S REPUBLIC OF CHINA 321 (Michael J. Moser ed., 1987). For a sample know-how contract, see RICHARD J. GOOSEN, TECHNOLOGY TRANSFER IN THE PEOPLE'S REPUBLIC OF CHINA 111 (1987). For examples of standard-form contracts covering various phases of contract negotiation, see THOMAS C.W. CHIU, CHINA TRADE DOCUMENTS 90-99 (2d ed. 1988).

211. For problems related to negotiating price and payment, see Alan W.S. Ng, *Payment Conditions Under Technology Transfer Import Contracts*, IP ASIA, Dec. 22, 1992, at 21. Mr. Ng notes that, in recent practice, remuneration for imported technology usually comes in two parts: a lump-sum transfer fee with subsequent periodic payments, with the lump-sum being paid in installments. Negotiating such matters gives rise to argument, manipulation, and delay. For a detailed commentary on other negotiation topics and problems inherent therein, see LEGAL ASPECTS OF DOING BUSINESS WITH CHINA, *supra* note 3, at 11-44.

212. GOOSEN, *supra* note 210, at 72-75. See discussion *supra* note 189.

213. GOOSEN, *supra* note 210, at 72-75. See also Stanley B. Lubman, *Technology Transfer to China: Policies, Law and Practice*, in FOREIGN TRADE, INVESTMENT, AND THE LAW IN THE PEOPLE'S REPUBLIC OF CHINA, *supra* note 210, at 170.

214. *Technology Transfer to China: The Decision Making Process*, *supra* note 174.

is now known as the Ministry of Foreign Trade and Economic Cooperation, or "MOFTEC."<sup>215</sup> Several new foreign trade bureaus have been created under MOFTEC.<sup>216</sup>

Because not all Chinese entities are authorized to enter into negotiations with foreign entities, the foreign entity must first examine the Chinese entity that it is dealing with to ensure that it has the proper authority to enter into negotiations and sign contracts. It must also consider whether the Chinese entity has the foreign exchange necessary to pay required licensing fees.<sup>217</sup>

### C. The Negotiating Process

In negotiating technology import contracts with Chinese parties, Western negotiators can look forward to long days. Chinese parties typically raise new issues toward the end of the day, requesting detailed price breakdowns, technical information, extra costs, and taxing living and working conditions.<sup>218</sup>

The Chinese prefer to use large negotiating teams to deal with foreigners. Yet, these teams have only limited authority and serve as protective "walls" for the Chinese.<sup>219</sup> The Chinese divide up responsibility for different phases of the contract among the members of these teams.<sup>220</sup> Several different schools of thought exist for dealing with them.

Observing that most Chinese negotiators imitate military tactics described in Sun Tzu's *Art of War*,<sup>221</sup> one school of thought recommends foreigners to study such methods for effective use and countering.<sup>222</sup> On the other hand, another school of thought considers it unwise to attempt to "out-Chinese the Chinese," as West-

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215. *MOFERT's New Look*, *supra* note 59, at 38-39.

216. *Id.*

217. See Chang & Pow, *supra* note 81, at 14; Dennis Kelley, *Technology Transfer Contracts: The Negotiating Process*, E. ASIAN EXECUTIVE REP., Oct. 1984, at 9. See also Lubman, *supra* note 213, at 180.

218. For a brief description of Chinese negotiating styles, see LEGAL ASPECTS OF DOING BUSINESS WITH CHINA, *supra* note 3, at 29-30.

219. Zhengdong Huang, *Negotiation in China: Cultural and Practical Characteristics*, in 6 China L. Rep. (CCH) ¶ 139 (1990). Analogizing China's negotiating teams to the Great Wall, Mr. Huang believes China uses large negotiating teams as psychological protective "walls." *Id.*

220. LEGAL ASPECTS OF DOING BUSINESS WITH CHINA, *supra* note 3, at 30.

221. SUN TZU, *THE ART OF WAR* (Samuel B. Griffith trans., 1963).

222. Christopher Engholm, *Asian Bargaining Tactics: Counter-strategies for Survival*, Pt. I, E. ASIAN EXECUTIVE REP., July 1992, at 9. Part Two of this article appeared in the August 1992 edition of the East Asian Executive Reports. This two-part article was ex-



ern negotiators are not thought to be capable of successfully adopting Chinese methods of negotiation.<sup>223</sup> This line of thinking cautions that it is inadvisable to attempt to teach the Chinese how to do business in China, as the Chinese understand their system and their culture better than Westerners.<sup>224</sup> The solution probably lies somewhere between the two extremes.

It is recommended that Western negotiators study and respect Chinese culture and grasp the importance of "face."<sup>225</sup> Unless the negotiator is Chinese, or has spent the bulk of his or her life in China to the extent of being both bilingual and bicultural, trying to second guess or intuit the true intentions of someone whose experiences, culture, and background differ vastly from his or her own may be more foolhardy than wise.

Every effort should be made to learn the identities and the backgrounds of the key Chinese negotiators. In most cases, however, obtaining such information may be difficult, if not impossible. Essential negotiating personnel on the foreign team include top management personnel, skilled and experienced technical specialists, and an interpreter fluent in Mandarin who possesses a good technical vocabulary.<sup>226</sup>

While the primary objective is communication, visual perception may also be critical. So that the position of each party is clearly understood, Western negotiators should not hesitate to use blackboards, charts, or other visual aids to convey their ideas.<sup>227</sup>

## VI. CONCLUSION

Technology transfers to China are significantly more complex than similar transactions with Western countries. Much of the

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cerpted from CHRISTOPHER ENGHOLM, *WHEN BUSINESS EAST MEETS BUSINESS WEST: THE GUIDE TO PRACTICE AND PROTOCOL IN THE PACIFIC RIM*.

223. Scott T. Jones, *Negotiating Agreements for China's Energy Future*, E. ASIAN EXECUTIVE REP., Apr. 1986, at 8. Mr. Jones astutely observes that it is difficult to adopt such Chinese tactics as looking inside for a solution or searching for alternative perceptions of what is being said. *Id.*

224. William A. Fischer, *The Educational Component*, E. ASIAN EXECUTIVE REP., Jan. 1986, at 8. Mr. Fischer emphasizes the educational component of technology transfers to China and comments on methods of training Chinese managers. In fact, the Xiamen Import Regulation requires the supplier to train the appropriate number of persons in the use of the technology (as determined by the recipient). *Id.*

225. Jones, *supra* note 223, at 8.

226. See Kelley, *supra* note 217.

227. Jones, *supra* note 223, at 8.

complexity is due to the several laws that impact upon contractual relations in China, and the fact that these laws are not addressed by one single statute. Complexity also arises due to the special needs of a technologically-emerging, lesser-developed country. The cultural differences between the East and the West also add to the complexity.

In addition to the FECL, the Civil Code impacts heavily on contractual relations. The Supreme Court's interpretation of the FECL also affects contracts. Thus, a simple reading of the FECL itself leaves considerable gaps in any understanding of Chinese contract law, because special laws exist for contracts involving technology transfers from foreigners to Chinese entities, which impact further on contractual relations.

An effort has been made herein to synthesize these several laws and view them as a working whole. It is the author's hope that a clear picture emerges of the legal framework within which technology transfers are made to China.

